

CRISIS IN THE EURO AREA

1. HISTORY OF THE EURO
2. WHAT DOES IT MEAN NOT TO HAVE YOUR OWN CURRENCY?
3. WHAT CAN THE GREEKS THEMSELVES DO?
4. COMMON FISCAL POLICY?



1. HISTORY OF THE EURO

Political project:

Helmut Kohl: *Germany our is our homeland. Europe is our future.*

The euro, a step towards a complete union.

Would tie a united Germany to the Western European democratic pillar.

The idea was good. The construction reasonable.

But practice before implementation was left out

And not properly followed up once established.



What does it take for a country to benefit from a currency union?

Cultural similarities in terms of attitude towards

- Low inflation
- Balanced budgets
- Wage formation contributing to economic stability

What can we say about Greece and Italy versus Germany and the Netherlands?

Large differences.

Should have had a trial and error period of at least five years.

Instead, economists investigate what they know something about,
ie. Optimum currency areas.

Business cycles fairly similar, and a currency union is fine.



The euro arrived in January 1999. Eleven countries were participating.

Only deposit money at the start

Three years later coins and notes introduced. Greece joined.

The Greek had manipulated the data. Goldman Sachs gave a helping hand.

Now 17 countries are using the euro.

Two important principles: :

- Stability and Growth Pact. Government budget deficits should not exceed 3% of GDP, and the government debt should not exceed 60% of GDP.
- No country should take any responsibility for other countries' public debt.

Both principles have been violated.



2003 – Germany exceeds the limits for government deficits.
The rules are changes and no fine is paid.
Consequences? Why should other countries follow the rules?

The crisis in 2008 – and the European Financial Stability Facility (EFSF)
is established, with the purpose of helping countries that have problems
repaying their government debts. (Greece, Portugal and Ireland).



2. WHAT DOES IT MEAN NOT TO HAVE YOUR OWN CURRENCY?

Can no longer devalue the currency to improve competitiveness.

Can no longer reduce real value of domestic debt through inflation.

Mechanisms for debt renegotiations are gone.

The problem is not that Greece can go bankrupt.

The problem is that Greece CAN NOT go bankrupt.



No bankruptcy court to send Greece to.

No system for who should bear what losses.

- Greek taxpayers
- Owners of Greek government bonds
- German taxpayers (and those in other eurozone countries)

Let owners of Greek government bonds take some of the losses

May cause trouble for German banks

If that happens, it is up to Angela Merkel to solve THAT problem.



Greek government debt was written off by around 50%

LTRO – longer-term refinance operation – banks in the eurozone can borrow loads of euros for 3 years at 1% interest

Purchase government bonds. Interest rates are falling in Spain, Italy etc. Who pays?

BUT: What will happen in 3 years when the loans must be repaid? And what incentives do the banks have to make the necessary adjustments?

NOMINAL "tricks" (increase in credit) do not solve
REAL problems (unemployment, innovation, productivity)



3. WHAT CAN THE GREEKS THEMSELVES DO?

- How to deal with substantial corruption?
- How to put in place a more efficient tax system?

Is wage reduction for everyone an option?

BUT: What will then happen with demand, production and employment?

Must distinguish between the **STOCK** and the **FLOW** issues

The first is related to the write-offs of debt.

The second to production, employment and income.



4. COMMON FISCAL POLICY

Eurobonds that all of the eurozone countries are collectively responsible for repaying, based on solidarity. Fiscal policy for each country becomes a matter to be discussed in Brussel.

Expanding the monetary union into a fiscal union.

This mean transfers between countries.

In the same way that there are tranfers within the USA, between states;
in China, between provinces; and in Norway, between fylker

BUT : Lack of democratic grounds for this.

Would require a time comsuming and complicate process

Is there enough solidarity among the 17 countries?

